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Consider a crash course in money, Mr. Buffett

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Dear Mr. Buffett, Now that my hair is grey and since I've learned so much from you over the years, I feel compelled to express my gratitude for your wisdom and example—but perhaps also qualified to offer some observations pertinent to the criticism you have recently received.

The wisest among our peers would agree that despite one's learning and past accomplishments, there are two immutable attributes that outstanding investors ought to possess: a sense of humility and one of skepticism. My own knowledge of you has come as a result of reading your own words and examining your actions rather than reading the hagiographies that our contemporaries have bestowed on you or the silly postings on gurufocus.com.

In that spirit of skepticism, allow me to suggest that there are perhaps two of you: The old Buffett (Old B) and the new one (New B). As I reflect upon your words and record over the many years, I can clearly see that the new replaced the old sometime around 1997, give or take a year or two. The Old B was a real investor: skeptical, keen, introspective, intellectually honest and possessing an unwavering eye as to what was right and wrong. I used to read your letters to Berkshire shareholders with a sense of appreciation for the judgment and clarity of your thoughts and convictions. But now it's all gone. The New B is lost in his own self-importance. He has become obsessed with his own legacy, having transformed himself into a participant and apologist for the failed credit culture of our times, even an evangelist for state intervention, favoritism and political entrepreneurship. Worse, this New B seems to have also lost his penchant for value and even become intellectually sloppy if not outright dishonest.

My personal library contains an archive of all your letters to Berkshire shareholders, going back to the brilliant days of the old Buffett Partnership in the late

1950s. I would be the first among many to acknowledge the trove of wisdom and judgment that can be found there. But I am thinking of discarding the letters of the New B. He writes too many words that are worth less and less.

Your most recent letter is an example of the intellectual sloppiness I mentioned earlier. There is nothing outstanding to be found among the many words but only warmed-over and self-exculpating arguments in your failure to see either the genesis of or the ongoing nature of a financial calamity that has become nothing short of tyrannical for the owner of any savings.

You are eager to remind us of your long-term track record. Often, it is to be found prominently in the first paragraph of your letters. But why is it that you never give it to us in inflation-adjusted terms? It's not that you don't understand inflation. Did you know, for example, that in the 10 years ended in 2001 the Berkshire shareholder had a total return of 536%—after inflation? But that in the subsequent 10 years ending in 2011, despite the sweet deals that you seem to get from your politically connected friends, your shareholder was merely 18.6% ahead? For ten whole years? It's the Old B and the New B, you see? Something happened somewhere, Mr. Buffett, and you seem to have missed it. Your value-seeking nose has steered you wrong. You know it but you want to pretend it isn't so.

But you don't just pretend. You preach to us the futility of owning gold as a useless and non-productive asset. Why mention it now, Mr. Buffett? Is it because you want to discredit something you don't quite understand, or because you want to defend your recent record of buying banks and homebuilding companies that are on a slow and winding road to extinction? Or is it that you want to defend the criminal government employees bent on money debasement as a way to save your railroad traffic?

Wouldn't you agree that the rest of us have a right to have savings (in addition to long-term investments) including the right to object to someone destroying them?

I suggest you consider reflecting on the very yardstick you use in measuring value—money. You are quite right that wealth is created on factory floors and not by holding a metal such as gold. We agree. Yet, what you do not seem to know, or perhaps have conveniently forgotten, is the nature of money in itself. Imagine a brilliant engineer who is indifferent as to the distinction between inches and centimeters but only minds the numbers. That's you. Your investment calculations have failed over and over again (well, except for those sweetheart deals you get with the warrants and everything), yet you don't seem to be concerned with the root cause of the distortions that have caused you so much grief. That's fine. But what I don't get is the arrogance and self-importance that is attached to your attack on those who see gold as a means of capital preservation—and have profited handsomely from their foresight for 11 years in a row. Why attack this now, Mr. Buffett? Why offer

disingenuous arguments to support a thesis that is not even part of your own investment methodology? Why attack? Are you envious? Did someone put you up to it? Did you have a bad morning?

You are not too old to go to basics and learn about money, Mr. Buffett. Moses did not lead his people out of Egypt until he was 80. By your own admission, you have long years ahead of you. So, if you still possess a bit of the humility and skepticism of old, consider a crash-course in money. You ought to start with Mises. That's Ludwig von Mises. Beyond that, you may wish to consider the idea that perhaps, just perhaps, you may be wrong about a few things. Barring such remedies, and being far too unimportant to give you advice, I will echo the sentiments of Mr. Chris Christie, the New Jersey governor. When he was recently asked by a reporter to comment about your silly neo-Marxist everyone-according-to-their-means idea, he suggested that you just "write a check and shut up." That's two pieces of advice. I'd forget about the check.

Sincerely yours,
OvS

WE READ

William Wright of the *Financial News* observes (19 February) that over the past six years, a sample of seven large banks that publish comparable data have paid their staff \$362 billion—nearly 3 times the aggregate \$124 billion they have generated in pre-tax profits. "This raises fresh questions," he writes, "about the appropriate division of rewards between employees and shareholders in the securities industry." We ask: what shareholders? There are no shareholders any longer. There are no owners. Only casino patrons.

In his now famous 2001 article "The Debasement of World Currency: It Is Inflation, But Not as We Know It," British economist Peter Warburton writes:

"What we see at present is a battle between the central banks and the collapse of the financial system fought on two fronts. On one front, the central banks preside over the creation of additional liquidity for the financial system in order to hold back the tide of debt defaults that would otherwise occur. On the other, they incite investment banks and other willing parties to bet against a rise in the prices of gold, oil, base metals, soft commodities, or anything else that

might be deemed an indicator of inherent value. Their objective is to deprive the independent observer of any reliable benchmark against which to measure the eroding value, not only of the US dollar, but of all fiat currencies. *Equally, they seek to deny the investor the opportunity to hedge against the fragility of the financial system by switching into a freely traded market for non-financial assets.*" *Emphasis ours.*

Swiss publicist Beat Cappelletti, writing for the *NZZ Sam Sonntag* on 12 February, draws striking parallels between the present day eurocrisis and France circa 1720: the reckoning of ever increasing government bonds to be collateral-worthy "assets", the four-fold increase in money supply (it subsequently increased 40-fold), the practice of camouflaging problems by creating succeeding government entities for such purpose and the utter lack of transparency. He writes: "In 1720, John Law wanted to drown the French government debt in paper money. Today, the ECB does the same with the debts of Southern European governments. The parallels are both stunning and terrifying ... In a cluttered chain of transactions, the governments of then and now plaster problems by

creating more and more salvation entities and rescue missions ... they also share a hasty and clumsy course of action, destroying confidence in themselves and their money along the way. One learns from history that nothing is learnt from history.”

Bridgewater’s Ray Dalio sums up our current financial system most succinctly and accurately: “You’ve got insolvent banks supporting insolvent sovereigns and insolvent sovereigns supporting insolvent banks.” In the meantime, the saver is put out to the dogs. A follow-up comes from our friend Jonathan Escott, quoting from Matthew Arnold’s “Dover Beach”:

*And we are here as on a darkling plain
Swept with confused alarms of struggle and flight,
Where ignorant armies clash by night.*

In the Q&A that followed your editor’s recent remarks to a group of investors in Madrid, one of the participants asked, “What’s your view on China?” The answer was as imprecise as it was truthful: “There is no example in history,” I said, “where central planning has brought about enduring prosperity. I am agnostic on China.” That’s not quite true but the more appropriate answer was not suited to a quick answer. “In China, every province is a Greece,” said Larry Lang recently. Admittedly this is a brazen description that leaves no room for argument, especially since Mr. Lang is Chair Professor of Finance at the Chinese University of Hong Kong and a man whose views are never quoted in the press. If the word ‘Greece’ has now become synonymous with excessive debt, lack of capacity to compete, full reliance on external financing for mere survival and entrenched corruption, Professor Lang’s analogy is frightening. And frankly, in view of the magnitude of confidence that the mainstream now ascribes to anything Chinese, the analogy is even more terrifying.

Read more: <http://tinyurl.com/ej-lang>.

In private correspondence following your editor’s remarks at a recent dinner in London, a banker friend writes: “Your discussion and anecdotes about volatility are so timely. I have noticed a common theme over the last 3–5 years, and that is a greater move towards a shorter term trading mentality (I can’t call it investing). Banks actually encourage it. They penalize a business if they own something for too long (be it an equity or a corporate bond). Traders seem to want volatility and banks try their best to come up with some measure of it so as to create an

illusion to their Boards and shareholders that they are somehow in control. I can’t tell you how many different VaR models I have seen over the last three years, all supposedly more robust than the next. The market is consumed with ‘risk on vs risk off’, not just daily but hourly. It has become a giant casino, the only difference being trading rooms have clocks and let in light. The ECB remains intent on saturating the market with liquidity; it does nothing for the solvency of countries. It has provided the market an excuse to be ‘risk on’ but all it does is stave off a banking crash and encourages them to recklessly adopt a carry trade. What a joke of a system, the ECB gives cheap money on term, banks buy crappy sovereign debt with it and use that very debt as the collateral to get more money that they will do the same thing with. I mean, you couldn’t make this stuff up if you tried. Investing going forward is going to be more about people than pricing models. I don’t know what value is all the time, but I do know when I find someone who is honest and that has to be a much larger component in the decision making process.”

Our old friend Murray Pollitt has passed away. He was a mining engineer, stockbroker, philosopher, economist and a fabulous writer. But he will be remembered for being a man of conviction, principle and old-fashioned ethic. He was firm and unbending on everything important and a fiery inspiration to everyone around him. In an investment world replete with every kind of falsehood, hyperbole and incompetence, Murray was a beacon in the night. In his eulogy, using words that rang true to everyone who knew him, his son Douglas had this to say: “For almost fifty years Murray made a cottage industry out of stripping away the pretensions, the embellishments and the soft fibs that so often cloak an investment proposition. From a standing start he could cut through an annual report (hard copy, always) in seventeen minutes flat and deliver the sorry verdict in three pithy lines. And he saw nothing wrong with delivering these three pithy lines to your face. Indeed, he relished this. Yet throughout all this, notwithstanding the occupational hazards of swimming upstream, he never once got his head lopped off.” I will always miss him.

It is always surprising to find analytical boldness among mainstream market participants. Somehow we are surprised more and more in recent times. An example comes from the February 2012 Investment Strategy Bulletin published by Swiss bankers

Lombard Odier, attesting that central banks have engaged in “the most innovative financial experiment of all times, of both expanding and altering the risk profile of their balance sheets.” The report acknowledges that the short-term aim of such experiments is to “lift the prices of financial assets” and then asks, “What about the real economy?” In stark departure from mainstream economic thinking, venturing beyond the nominal in a manner quite unusual for a Swiss bank, they continue: “Ballooning and riskier central bank balance sheets will not generate sustainable growth or reduce unemployment and debt levels, but could well induce at a later stage unintended consequences that include bouts of hyperinflation, loss of trust in fiat money and loss of central banks’ credibility...”

Ultimately, when the velocity of circulation of money kicks in, and it will, and money floods real economic activity and interest rates rise, two observations: (a) None of the new money would represent real economic activity, and (b) the errors made in a free money environment of the past will be unmasked.

To effect a non-inflationary outcome, Lombard Odier says that the “monetary base expansion will need to be reversed in large, non-incremental steps.” And then adds that this is “uncharted territory for central banks.” A polite way to say that it ain’t possible to do.

One of these days, some enterprising researcher will be able to publish a 900-page book set in rather small print, containing the combined foolishness, cluelessness and utter stupidity that characterize virtually all that has come from the mouths of government employees in recent years. For anyone contemplating such a bestseller, here is a worthy media clipping from the *Washington Post*, 27 October 2005:

“U.S. house prices have risen by nearly 25 percent over the past two years, noted Bernanke, currently chairman of the president’s Council of Economic Advisers, in testimony to Congress’s Joint Economic Committee. But these increases, he said, ‘largely reflect strong economic fundamentals,’ such as strong growth in jobs, incomes and the number of new households.”

Another candidate, Larry Summers: “Government has no higher responsibility than insuring economies have an adequate level of demand.”

— <http://tinyurl.com/ej-summers>, courtesy of D. Grice.

Media analyst and author Douglas Rushkoff on the subject of reality and illusion:

“Or take money: there’s the thing of value—the labor, the chicken, the shoe. Then there’s the thing we use to represent that value—say gold, grain receipts, or gold certificates. But once we get so used to using those receipts and notes as the equivalent of a thing with value, we can go one step further: the federal reserve note, or ‘fiat’ currency, which has no connection to gold, grain, or the labor, chickens and shoes. Three main steps: there’s value, the representation of value, and then the disconnection from what has value.

“But that last disconnection is the important one—the sad one, in many respects. Because that’s the moment that we forget where things came from—when we forget what they represent. The simulation is put forth as reality. The invented landscape is naturalized, and then mistaken for nature.

“And it’s when we become so particularly vulnerable to illusion, abuse, and fantasy. For once we’re living in a world of created symbols and simulations, whoever has control of the map has control of our reality.”

Read more: <http://tinyurl.com/ej-rushkoff>, courtesy of J. Escott.

In a thoroughly enjoyable article for the *American Spectator* entitled “America’s Ruling Class—And the Perils of Revolution,” (July/August 2010), Angelo M. Codevilla, Professor Emeritus of International Relations at Boston University, writes:

“While the unenlightened ones believe that man is created in the image and likeness of God and that we are subject to His and to His nature’s laws, the enlightened ones *know* that we are products of evolution, driven by chance, the environment, and the will to primacy. While the unenlightened are stuck with the antiquated notion that ordinary human minds can reach objective judgments about good and evil, better and worse through reason, the enlightened ones *know* that all such judgments are subjective and that *ordinary people can no more be trusted with reason than they can with guns*. Because ordinary people will pervert reason with ideology, religion, or interest, science is ‘science’ only in the ‘right’ hands. Consensus among the right people is the only standard of truth. Facts and logic matter only insofar as proper authority acknowledges them.” *Emphasis original.*

Count me among the unenlightened.

Read more: <http://tinyurl.com/ej-codevilla>. ●